Do Natural Resources Support Economic Growth?

BY BECKY JOHNSEN

The management of natural resources is important for all countries, but perhaps especially so for developing countries. From rare earth minerals to oil to diamonds, certain countries have been endowed with resources that theoretically should bestow wealth and trading leverage. Nonetheless, many countries that possess these riches still suffer from poor economic conditions. This phenomenon was labeled the "natural resource curse" by economist Richard Auty in 1993. Since then, researchers have done considerable work on this topic.

Among the most recent of these articles, Harvard University Economist Jeffrey Frankel consolidates the oftentimes opposing conclusions on the resource curse into a single survey. In his essay, Frankel cites potential causes of the natural resource curse, as well as examples of both poor and prudent policy decisions to counteract the phenomenon. Finally, Frankel proposes various policies that have never been implemented, but according to much of the existing literature, should be effective.

"The Natural Resource Curse: A Survey." Jeffrey A. Frankel. National Bureau of Economic Research Working Paper no. 15836, March 2010.

According to Frankel, the term "natural resource curse" is relatively self-explanatory, that "... the possession of oil, natural gas, or other valuable mineral deposits or natural resources does not necessarily confer economic success." He admits that the term seems counterintuitive, but points to one particular natural resource to help illustrate the term: "... it is best to view oil abundance as a double-edged sword, with both benefits and dangers."

Frankel then identifies the six "channels" which suggest that "possession of natural resources ... can confer negative effects on a country, along with the benefits." He begins with one channel that has been much debated among economists, the downward long-term trend in commodity prices. Frankel frames the debate as one between "Malthusianism," the idea that population growth comes at the cost of diminishing stores of natural resources, versus "cornucopianism," the belief that resources are renewable or replaceable.

In the end, Frankel concludes that both sides have their shortcomings. "Malthusians do not pay enough attention to the tendency for technological progress to ride to the rescue. On the other hand, the fact that the Malthusian forecast has repeatedly been proven false in the past does not in itself imply the Panglossian forecast that this will always happen in the future." Because of this, Frankel does not believe that there is conclusive evidence for this to be a factor in the natural resource curse. "[I] largely rejected the hypothesis of a long-term negative trend in world prices, while accepting the hypothesis of high volatility."

Nonetheless, Frankel identifies five other channels that he perceives as plausible reasons for the natural resource curse. The first three are the high volatility of commodity prices, the crowding out of the manufacturing sector as a result of resource specialization, and the fact that "mineral riches can lead to civil war." The final two are that endowments of natural resources can lead to poor institutions, and the Dutch Disease, which suggests that a commodity boom can lead to real appreciation of the domestic currency and increased government spending. Once the boom dies down it is difficult to readjust from appreciation and high spending.

Frankel cites policies that national governments have tried to combat the resource curse, including marketing boards, taxation of commodity production, producer subsidies, other government stockpiles, price controls for consumers and international cartels.

Frankel proposes that some institutions may succeed in a variety of ways and offers three examples that should effectively share risk. These are price-setting in contracts with foreign companies, hedging in commodity futures markets, and denomination of debt in terms of commodity price. He also promotes two means of effective monetary policy: managed floating and alternative nominal anchors.

Finally, Frankel points to several historical examples where governments were successful in mitigating harms associated with the resource curse. First, he cites reserve accumulation by central banks. Next, he discusses Chile's rules for the budget deficit, and then Sao Tome and Principe's sovereign wealth funds. He then points to Alaska's practice of lump-sum distribution in booms. His final two examples are the process of reducing net private capital inflows during booms and the effort to impose external checks. Frankel demonstrates that there are several ways to fall victim to the natural resource curse, but also that a variety of institutions are at a government's disposal.

Frankel avoids generalizations by addressing different channels and institutions in existence by various resource-rich nations. Frankel has a cautiously optimistic conclusion about the natural resource curse. "Needless to say, policies and institutions are influenced by local circumstances, country by country. But with innovative thinking, there is no reason why resource-rich countries need fall prey to the curse." Essentially, through understanding the potential externalities of resource wealth, countries can implement effective policies to escape the resource curse, he concludes. **RF**